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BRIEF

Nos. 13-354 and 13-356

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In the Supreme Court of the United States

KATHLEEN SEBELIUS, SECRETARY OF HEALTH AND HUMAN SERVICES, ET AL., PETITIONERS

v.

HOBBY LOBBY STORES, INC., ET AL., RESPONDENTS

CONESTOGA WOOD SPECIALTIES CORP., ET AL., PETITIONERS

v.

KATHLEEN SEBELIUS, ET AL., RESPONDENTS

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH AND THIRD CIRCUITS

AMICUS CURIAE BRIEF OF CORPORATE AND CRIMINAL LAW PROFESSORS IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICI CURIAE*

Amici are forty-four law professors whose research and teaching focus primarily on corporate and securities law and criminal law as applied to corporations.[1] See Appendix A (listing the individual law professors joining this brief). This brief addresses those issues that are specifically within *amici*'s particular areas of scholarly expertise.[2]

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[1] Conestoga Wood Specialties Corporation (Conestoga) and Petitioners Kathleen Sebelius, Secretary of Health and Human Services, et al. previously filed with the Court letters consenting to the filing of *amicus curiae* briefs. Hobby Lobby Stores, Inc. (Hobby Lobby) separately consented to the filing of this brief, such consent letter which is lodged herewith. Pursuant to Rule 37.6, *amici* also state that this brief was not authored in whole or in part by counsel for any party and that no one other than *amici* and their counsel made any monetary contribution to the preparation or submission of this brief.

[2] Thus, this brief does not address (1) whether the Patient Protection and Affordable Care Act (PPACA) contraceptive mandate "substantially burdens" the "exercise of religion" within the meaning of the Religious Freedom and Restoration Act (RFRA); or (2) whether this Court's decision in *Citizens United* v. *FEC*, 558 U.S. 310 (2010), which concerned the First Amendment's Free Speech Clause, has any bearing on the outcome of Hobby Lobby's and Conestoga's RFRA claims. *Amici* understand that experts in religion and constitutional law will file *amicus* briefs addressing such issues. In addition, because Hobby Lobby and Conestoga are for-profit corporations, this brief does not specifically address non-profit corporations, limited liability companies, or partnerships.

SUMMARY OF ARGUMENT

Hobby Lobby and Conestoga each asserts that the religious values of its present controlling shareholders should pass through to the corporation itself. This Court should reject any such "values pass-through" concept. To do otherwise would run contrary to established principles of corporate law.

1. The essence of a corporation is its "separateness" from its shareholders. It is a distinct legal entity, with its own rights and obligations, different from the rights and obligations of its shareholders. This Court has repeatedly recognized this separateness.

2. Shareholders rely on the corporation's separate existence to shield them from personal liability. When they voluntarily choose to incorporate a business, shareholders cannot then decide to ignore, either directly or indirectly, the distinct legal existence of the corporation when it serves their personal interests.

3. The separateness between shareholders and the corporation that they own (or, in this case, own and control) is essential to promote investment, innovation, job generation, and the orderly conduct of business. This Court should not adopt a standard that chips away at, creates idiosyncratic exceptions to, or calls into question this legal separateness.

4. On the facts of these cases, there is no basis in law or in fact to disregard the separateness between shareholders and the corporations they control. Hobby Lobby's and Conestoga's attempt to "reverse veil pierce"—that is, to imbue the corporation, either by shareholder fiat or a board resolution, with the religious identity of certain of its shareholders—should

be rejected. The concept of "reverse veil piercing" is wholly inapplicable on these facts.

5. Adoption by this Court of a "values pass-through" theory here would be disruptive to business and generate costly litigation. It would encourage intrafamilial and intergenerational disputes. It would also encourage subterfuge by corporations seeking to obtain a competitive advantage.

6. Adoption by this Court of a "values pass-through" theory would also have potentially dramatic and unintended consequences with respect to laws other than PPACA, such as the Public Accommodations and Employment Discrimination provisions of the Civil Rights Act of 1964. Rather than open up such a Pandora's box, the Court should simply follow well-established principles of corporate law and hold that a corporation cannot, through the expedient of a shareholder vote or a board resolution, take on the religious identity of its shareholders.

ARGUMENT

I. ATTRIBUTING TO A CORPORATION THE RELIGIOUS IDENTITY OF ITS CONTROLLING SHAREHOLDERS IS CONTRARY TO CORPORATE LAW.

A. A CORPORATION IS A LEGAL ENTITY, SEPARATE AND DISTINCT FROM ITS SHAREHOLDERS.

The first principle of corporate law is that for-profit corporations are entities that possess legal interests and a legal identity of their own—one separate and distinct from their shareholders. This is true whether the for-profit corporation has one, one hundred, or one million shareholders. In each scenario,

the corporate entity is distinct in its legal interests and existence from those who contribute capital to it.

This Court has repeatedly recognized this principle of strict separation. As this Court has recognized, a "corporation and its stockholders are generally to be treated as separate entities." *Burnet* v. *Clark*, 287 U.S. 410, 415 (1932); see also *New Colonial Ice Co.* v. *Helvering*, 292 U.S. 435, 442 (1934). This Court has gone so far as to call this "'a general principle of corporate law deeply ingrained in our economic and legal systems * * * .'" *United States* v. *Bestfoods*, 524 U.S. 51, 61 (1998) (quoting William O. Douglas & Carrol M. Shanks, *Insulation from Liability Through Subsidiary Corporations*, 39 Yale L.J. 193 (1929), and citing *Burnet*). "After all," the Court has emphasized, "incorporation's basic purpose is to create a distinct legal entity, with legal rights, obligations, powers, and privileges different from those of the natural individuals who created it, who own it, or whom it employs." *Cedric Kushner Promotions, Ltd.* v. *King*, 533 U.S. 158, 163 (2001).

The centrality of corporate "separateness" is well-established in the United States. More than a century ago, Justice Holmes observed: "A leading purpose of [corporation] statutes and of those who act under them is to interpose a nonconductor, through which, in matters of contract, it is impossible to see the men behind them." *Donnell* v. *Herring-Hall-Marvin Safe Co.*, 208 U.S. 267, 273 (1908); see also *Klein* v. *Bd. of Tax Supervisors of Jefferson Cnty., Ky.*, 282 U.S. 19, 24 (1930) (explaining that a corporate entity "is a person and its ownership is a nonconductor that makes it impossible to attribute an interest in its property to its members.").

Indeed, this legal separateness—sometimes called legal "personhood"—has been the very basis of corporate law at least since the 18th Century. See William Blackstone, 1 COMMENTARIES ON THE LAWS OF ENGLAND 456-67 (U. Chicago Press 1979) ("[I]t has been found necessary, when it is for the advantage of the public to have any particular rights kept on foot and continued, to constitute artificial persons, who may maintain a perpetual succession, and enjoy a kind of legal immortality. These artificial persons are called bodies politic, bodies corporate, * * * or corporations."); see also *The Queen* v. *Arnaud*, (1846) 115 Eng. Rep. 1485 (Q.B.) (holding that a British corporation with non-British members was entitled to register a vessel under a law limiting vessel registration to British subjects).

Today, legal separateness is recognized in every state, including Oklahoma, the home of Hobby Lobby, and Pennsylvania, the home of Conestoga. See *Kurtz* v. *Clark*, 290 P.3d 779, 785 (Okla. Civ. App. 2012) (recognizing "'the legal concept of corporate entity under which stockholders as such lose their individualities in the individuality of the corporation as a separate and distinct person'" (quoting *Dobry* v. *Yukon Elec. Co.*, 290 P.2d 135, 137 (Okla. 1955))); *Barium Steel Corp.* v. *Wiley*, 108 A.2d 336, 341 (Pa. 1954) ("It is well established that a corporation is a distinct and separate entity, irrespective of the persons who own all its stock. The fact that one person owns all of the stock does not make him and the corporation one and the same person, nor does he thereby become the owner of all the property of the corporation. The shares of stock of a corporation are essentially distinct and different from the corporate property.").

B. The Corporation's Separate Existence Protects Its Shareholders From Liability for Corporate Debts, Thereby Encouraging Investment, Innovation, and Job Generation.

Because the corporation is a separate entity, its shareholders are not responsible for its debts. This "privilege of limited liability," as protected by the corporate veil, is "the corporation's most precious characteristic." William W. Cook, The Principles of Corporation Law 19 (1925).

Although the term "corporation" sometimes calls to mind large, publicly-traded corporations, incorporation provides equally critical benefits to smaller, private businesses. One of the most compelling reasons for a small business to incorporate is so that its shareholders can acquire the protection of the corporate veil. By incorporating a business, the founders and investors do not put their personal assets at risk. Absent significant misconduct and fraud, a shareholder in a corporation cannot lose any more than her original investment. If the corporation cannot pay its bills, the creditors—not the shareholders—bear the loss, with only very narrow exceptions.[3]

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[3] The leading treatise on closely-held corporations notes that, in addition to limited liability,

> [t]here may [be other benefits] from the recognition of the separate entity[:] the participants in the enterprise may be entitled to claim benefits as an employee for purposes of workers' compensation, social security, unemployment compensation or other

Even where a single shareholder owns 100% of the corporation's shares, the corporate veil cannot be pierced absent significant misconduct or fraud on the part of the shareholder. This impermeability of the corporate veil has been confirmed by "thousands of instances where a sole shareholder was held not liable for either tort or contract obligation of his wholly-owned corporation." George D. Hornstein, CORPORATION LAW AND PRACTICE § 751 (1959).

The rationale behind the corporate veil is simple: by creating the corporate veil, legislators wanted to encourage entrepreneurial activity by founders, investment by passive investors, and risk-taking by corporate managers. The corporate veil is a simple device that helps to achieve all three of these goals.

Allowing a corporation, through either shareholder vote or board resolution, to take on and assert the religious beliefs of its shareholders in order to avoid having to comply with a generally-applicable law with a

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> entitlement statutes. A corporate officer or employee who is also the sole or controlling shareholder of the corporation has sometimes been able to assert successfully a claim as an employee for workers' compensation. Similarly, some courts respect the separate entity of a close corporation so that shareholder-employees qualify for social security benefits for which they would not be eligible if self-employed.

F. Hodge O'Neal & Robert B. Thompson, 1 O'NEAL AND THOMPSON'S CLOSE CORPORATIONS AND LLC'S: LAW AND PRACTICE § 1:10 (3d ed. 2004).

secular purpose is fundamentally at odds with the entire concept of incorporation. Creating such an unprecedented and idiosyncratic tear in the corporate veil would also carry with it unintended consequences, many of which are not easily foreseen. For example, adopting a "values pass-through" theory or "reverse veil piercing" in this case could make the raising of capital more challenging, recruitment of employees more difficult, and entrepreneurial energy less likely to flourish. As a matter of policy, as well as well-established principles of corporate law, this Court should reject Hobby Lobby's and Conestoga's claims.

C. The Corporation's Separate Existence Permits a Business to Operate Notwithstanding the Death or Disability of Its Founders or Changes in Share Ownership, Thereby Promoting Stability and Predictability in Business Operations.

In addition to the corporate veil separating shareholders from the corporation, another key feature of corporations is what known as "capital lock-in." Once an investor makes a capital contribution to the corporation, the money stays with the corporation, subject only to the decision of the board of directors to deploy it, reinvest it, or distribute it to shareholders in the form of dividends. See Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. Rev. 387, 388-89 (2003). Thus, for example, if a shareholder dies, her money stays in the corporation. Similarly, if shareholders become unhappy with management, they cannot demand their money back. This piece of the corporate architecture—a departure

from the traditional laws of partnership—is essential to the stability of incorporated businesses, the confidence of lenders, and the willingness of trading partners to do business with a corporation. See *id.* (arguing that capital "lock-in" is one feature that has "made the corporate form so useful in the development of modern industrial economies").

Capital lock-in also permits what has long been known as the "perpetual existence" of corporations. Perpetual existence simply means that, as shareholders die, distribute their shares to following generations, or sell their shares to newcomers, the corporation does not founder or dissolve. Instead, the corporation keeps operating—even if the new shareholders hold different religious, social, political, or business views from those who came before them. Such transitions in ownership are not limited to publicly-traded corporations. Such transitions happen to closely-held and family-owned corporations as well due to, *inter alia*, death, disability, divorce, or generational shifts.

If this Court were to accept the arguments being advanced by Hobby Lobby and Conestoga, it would encourage disruptive and inefficient disputes as share ownership is transferred down through the generations. It would invite contentious shareholder meetings, disruptive proxy contests, and expensive litigation regarding whether the corporation should adopt a religion and, if so, which one. Even where the controlling shareholders are not religious at all, directors installed by the prior controlling shareholders may be. In addition, non-religious shareholders or directors might decide that voting the corporation a religious identity will provide the corporation an advantage over its competitors (namely, by relieving

the corporation of its obligation to comply with a generally-applicable law). Indeed, it is not difficult to foresee the possibility that a shareholder would bring a derivative suit if the board of directors *refuses* to imbue the corporation with a religious identity that might relieve the corporation of the obligation to comply with generally-applicable laws and regulations and thereby give it a competitive business advantage. None of this is good for the stability—or profitability—of the corporation. And it is avoidable, simply by rejecting the values pass-through theory.

D. The Separation Between a Corporation and Its Shareholders is a Principle Not Only of Corporate Law, but also of Agency Law and Criminal Law.

Many different areas of law build upon the fundamental principle that a corporation is an entity separate and distinct from its shareholders. In agency law, for example, shareholders have no authority to act on behalf of the corporation or to bind the corporation to any legal commitments. James D. Cox & Thomas Lee Hazen, Business Organizations Law § 7.01 (3d ed. 2011).

Under both federal and state procedure, shareholders generally do not have standing to bring suit on their own behalf for injuries suffered by the corporation. See *Rawoof* v. *Texor Petroleum Co.*, 521 F.3d 750, 757 (7th Cir. 2008) ("[A] shareholder generally cannot sue for indirect harm he suffers as a result of an injury to the corporation."). Such suits may only be brought derivatively, in the name of the corporation and in the corporation's behalf, when the corporation has improperly failed to assert a corporate

claim. See Fed. R. Civ. P. 23.1; see also, *e.g.*, Del. Ch. Ct. R. 23.1.[4]

By the same token, corporations should not be able to sue to assert the rights of their shareholders. For-profit corporations are not like membership organizations, which are deemed to share the values of their members and have standing to sue on their members' behalf. See *Hunt* v. *Wash. State Apple Adver. Comm'n*, 432 U.S. 333, 343 (1977). Corporations are legally distinct entities whose shareholders may have idiosyncratic investment objectives and distinctive—and changeable—economic needs.

That a corporation is distinct from its individual constituents is also firmly rooted in criminal law doctrine. See generally *Cedric Kushner*, 533 U.S. 158 (holding that sole shareholder and president was a "person" distinct from the corporate "enterprise" under RICO statute). Because of this, a corporation may be found guilty while the sole shareholder is acquitted. See *State* v. *Christy Pontiac-GMC, Inc.*, 354 N.W. 2d 17 (Minn. 1984). Similarly, a shareholder may be found guilty while the corporation is not charged with a crime. See Ellen S. Podgor et al., HORNBOOK ON WHITE COLLAR CRIME § 2.7 (2013) (detailing situations where high-level executives are charged and found

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[4] Although some states allow shareholders to bring a direct action in narrow circumstances—specifically, when the shareholder has suffered a "separate and distinct injury," *Crosby* v. *Beam*, 47 Ohio St. 3d 105, 107 (1989)—the Delaware Supreme Court has rejected this putative exception to the derivative rule. See *Tooley* v. *Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1035 (Del. 2004).

guilty while the corporation enters into a non-prosecution or deferred prosecution agreement).

The separateness of corporations and their individual shareholders is also exemplified by the rights afforded to individuals that do not pass to the corporate entity. The "entity exception" limits the rights of "persons" under the Fifth Amendment to "natural persons." See generally *Hale* v. *Henkel*, 201 U.S. 43 (1906), overruled on other grounds by *Murphy* v. *Waterfront Comm'n of N.Y. Harbor*, 378 U.S. 52 (1964). In *Hale*, this Court noted the policy reasons for distinguishing between individual rights and corporate rights under the Fifth Amendment:

> [T]he corporation is a creature of the state. It is presumed to be incorporated for the benefit of the public. It receives certain special privileges and franchises, and holds them subject to the laws of the state and the limitations of its charter. * * * While an individual may lawfully refuse to answer incriminating questions unless protected by an immunity statute, it does not follow that a corporation, vested with special privileges and franchises, may refuse to show its hand when charged with an abuse of such privileges.

Id. at 74-75. This principle was reaffirmed in *United States* v. *White*, 322 U.S. 694, 700 (1944), where this Court stated: "The framers of the constitutional guarantee against compulsory self-disclosure, who were interested primarily in protecting individual civil liberties, cannot be said to have intended the privilege

to be available to protect economic or other interests of such organizations so as to nullify appropriate governmental regulations." Thus, while individuals can claim a Fifth Amendment privilege, entities are precluded from equivalent rights. The entity exception has been applied even when the entity embodied personal as well as group interests. See *Bellis* v. *United States*, 417 U.S. 85 (1974) (applying the entity exception to partnership records).

Importantly, moreover, this Court has recognized the distinction even between a *sole shareholder* and the corporation for purposes of the Fifth Amendment. In *Braswell* v. *United States*, 487 U.S. 99 (1988), this Court ruled that the sole shareholder of a corporation has no Fifth Amendment right to resist a subpoena to the corporation for corporate documents that personally incriminate him.

The principle of corporate separateness is both strong and enduring. Nothing in the cases now before this Court should cause this Court to disregard the principle or to call it into any question, or to allow a corporation through either direct shareholder action or a board resolution, to simply "take on" the religious identity of its shareholders.

E. This Court Should Not Allow Hobby Lobby and Conestoga to Selectively Disregard the Corporate Veil That Separates Them From Their Shareholders.

In the present cases, Hobby Lobby and Conestoga argue that they should be exempt from federal law because of the religious values of their controlling shareholders, while seeking to maintain the benefits of

corporate separateness for all other purposes. These corporations have benefited from their separateness in countless ways, and their shareholders have been insulated from actual and potential corporate liabilities since inception. Yet now they ask this Court to disregard that separateness in connection with a government regulation applicable solely to the corporate entity.

Hobby Lobby and Conestoga want to argue, in effect, that the corporate veil is only a one-way street: its shareholders can get protection from tort or contract liability by standing behind the veil, but the corporation can ask a court to disregard the corporate veil on this occasion.

Hobby Lobby and Conestoga cannot have it both ways. This Court has repeatedly held that corporations and their controlling shareholders cannot invoke the corporate veil on the one hand and ask courts to disregard it on the other. See *Schenley Distillers Corp.* v. *United States*, 326 U.S. 432, 437 (1946) ("One who has created a corporate arrangement, chosen as a means of carrying out his business purposes, does not have the choice of disregarding the corporate entity in order to avoid the obligations which the statute lays upon it for the protection of the public."); *Moline Props., Inc.* v. *Comm'r*, 319 U.S. 436 (1943) (holding that even a sole shareholder cannot seek to sidestep a corporation's "separateness" to gain a personal tax advantage).

Hobby Lobby's and Conestoga's position—that the personal religious values of a corporation's controlling shareholders may be "passed through" to, or injected into, the corporation they own—is inconsistent with

the protection that the corporation's separate existence provides to the shareholders, i.e., the corporate veil. Moreover, this Court's ruling in *Domino's Pizza, Inc.* v. *McDonald*, 546 U.S. 470 (2006), flatly repudiates the major premise on which Hobby Lobby's and Conestoga's argument rests.

In *McDonald*, an African-American individual was the sole shareholder of a corporation that had entered into several contracts with Domino's. Alleging that Domino's breach of those contracts was racially motivated and violated his civil rights, he brought a claim under 42 U.S.C. § 1981. This Court rejected his claim, explaining that

> it is fundamental corporation and agency law—indeed, it can be said to be the whole purpose of corporation and agency law—that the shareholder and contracting officer of a corporation has no rights and is exposed to no liability under the corporation's contracts. * * * The corporate form and the rules of agency protected his personal assets, even though he negotiated, signed, performed, and sought to enforce contracts for [the corporation]. The corporate form and the rules of agency similarly deny him rights under those contracts.

Id. at 477 (internal quotation marks omitted). Under *McDonald*'s reasoning, the religious values of Hobby Lobby's and Conestoga's shareholders cannot be "passed through" to the corporate entity, and any "burden" that the contraceptive mandate imposes on

the corporate entity does not constitute a cognizable "injury" to the individual shareholders.[5]

F. "Reverse Veil Piercing" Has No Application to the Facts in These Cases.

One corporate law scholar has recently suggested that the practice of "reverse veil-piercing" might justify a "religious values pass-through" from controlling shareholders to the corporation. Stephen M. Bainbridge, *Using Reverse Veil Piercing to Vindicate the Free Exercise Rights of Incorporated Employers*, 16 Green Bag 2d 235 (2013). This argument fundamentally misunderstands the reverse piercing remedy.

As a general rule, reverse piercing is an equitable remedy, employed to permit creditors of an individual shareholder to reach the assets of a corporation in

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[5] This Court previously has recognized that "the corporate form may be disregarded in the interests of justice where it is used to defeat an overriding public policy." *Bangor Punta Operations, Inc.* v. *Bangor & Aroostook R.R.*, 417 U.S. 703, 713 (1974). But this does not advance Hobby Lobby's and Conestoga's arguments here. *Bangor Punta* was not a case where the corporation was asking that a court disregard the veil that served to protect it and its shareholders. Instead, invoking equitable principles, this Court held that a shareholder who had acquired a 99% controlling interest in a company at a fair price could not then succeed in a derivative action against the company's former owner for alleged corporate waste and mismanagement that had occurred long before the purchase. *Id.* at 705, 716 (holding that, were such a suit allowed to be maintained, the new owner would "reap[] a windfall").

which she holds stock. See, *e.g.*, *Dzikowski* v. *Friedlander*, 411 B.R. 434, 441 (Bankr. S.D. Fla. 2009). What Hobby Lobby and Conestoga seek in these cases is to engage in a discredited variation on reverse veil piercing, known as "insider reverse piercing." In a "typical" insider reverse piercing case, "a corporate insider, or someone claiming through such individual, attempt[s] to pierce the corporate veil from within so that the corporate entity and the individual will be considered one and the same." *Postal Instant Press, Inc.*, v. *Kaswa Corp.*, 77 Cal. Rptr. 3d 96, 101 (Cal. Ct. App. 2008).

The law strongly opposes insider reverse veil piercing. The reasoning behind this opposition is straightforward: veil piercing is a doctrine of equity, guided by equitable considerations, and reverse veil piercing at the request of an insider who has consciously chosen the corporate form by which to do business is hardly equitable. See, *e.g.*, *Uniboard Aktiebolag* v. *Acer Am. Corp.*, 118 F. Supp. 2d 19, 25 (D.D.C. 2000) ("[T]he law generally does not allow the option of 'reverse piercing' the corporate veil when it suits the corporation's owner.").

Moreover, Hobby Lobby's and Conestoga's position is not supported by cases that pierce the corporate veil in order to fulfill a federal or state directive. In such cases, federal and state courts may invoke veil piercing because a corporation was created for the transparent purpose of evading state or federal policy. See, *e.g.*, *Anderson* v. *Abbott*, 321 U.S. 349, 362-63 (1944); *Ill. Bell Tel. Co.* v. *Global NAPS Ill., Inc.*, 551 F.3d 587, 598 (7th Cir. 2008); *Bhd. of Locomotive Eng'rs* v. *Springfield Terminal Ry. Co.*, 210 F.3d 18, 26-27 (1st Cir. 2001). By contrast, there is no allegation

that Hobby Lobby's or Conestoga's shareholders created their respective corporations as a contrivance in order to evade a federal or state directive. Thus, these facts are different from, for example, cases in which state usury laws limited to individuals are evaded by the borrower purposely incorporating so as to obtain a loan at rates usurious if applied to individuals.[6] See, *e.g.*, *Atlas Subsidiaries of Fla., Inc.* v. *O & O, Inc.*, 166 So. 2d 458 (Fla. Dist. Ct. App. 1964).

In short, well-established corporate law principles do not support the suggestion that the religious identity of the corporation's controlling shareholders should pass through to and exempt those corporations from compliance with generally applicable laws and regulations. Because Hobby Lobby and Conestoga have taken full advantage of the benefits of incorporation, they cannot now disregard the wall of separation that incorporation requires.

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[6] This is also not a case where the decision to incorporate a family farm has threatened a shareholder's homestead exemption. See, *e.g.*, *Cargill, Inc.* v. *Hedge*, 375 N.W.2d 477 (Minn. 1985) (ignoring the fact that a farm had been incorporated in order to permit the sole owner of the corporation to keep her homestead exemption); *State Bank in Eden Valley* v. *Euerle Farms, Inc.*, 441 N.W.2d 121 (Minn. Ct. App. 1989) (same).

II. RECOGNIZING "VALUES PASS-THROUGH" AND/OR "REVERSE VEIL PIERCING" WOULD BE DISRUPTIVE TO BUSINESS AND HAVE IMPLICATIONS FAR BEYOND THE CONTRACEPTIVE MANDATE.

A. Permitting Controlling Shareholders to Imbue the Corporation With Their Religious Identity Would Invite Intrafamilial and Intergenerational Disputes and Generate Costly Litigation.

Shareholders in closely-held and family-owned businesses often find themselves in disputes over values. Factions emerge; majority shareholders gang up on minority shareholders; dissenters lose their jobs and are excluded from decision-making; dividends previously paid and relied upon are discontinued; etc. In such circumstances, minority shareholders find themselves with no economic return on their share ownership. Corporate law casebooks are filled with these dramas.

This factionalizing and exclusion of minority shareholders is statutorily known as "oppression." See Model Bus. Corp. Act § 14.30. Sometimes oppression gives rise to injunctive relief, imposition of damages, forced buy-backs of shares, and even dissolution of the corporation. Cox & Hazen, *supra*, at § 14.12; F. Hodge O'Neal & Robert B. Thompson, 1 Oppression of Minority Shareholders and LLC Members §§ 7.3-9 (2010). Sometimes, it merely results in heartache and fractured families.

Running a family business is difficult enough, even without infusing disruptive and personal issues such as

religion into the mix. Under a values pass-through theory, one can imagine majority shareholders "freezing out" family members who do not adhere to the majority's religious beliefs. Would failure to attend church, or to participate in the majority's favored religious practices, form a legitimate basis for exclusion in a values pass-through regime? See Faith Stevelman, *Going Private at the Intersection of the Market and the Law*, 62 Bus. Law. 775 (2007) (describing "freeze out" transactions in which majority shareholders can eliminate minority shareholders from the corporation without providing a business justification and at less than full value).

If this Court were to agree that, as a matter of federal law, shareholders holding a control bloc of shares in a corporation may essentially transfer their religious beliefs to the corporation, the results could be overwhelming. Federal courts faced with RFRA and Free Exercise Clause lawsuits would be forced to resolve questions about what degree of ownership constitutes "control."[7] They would also be forced to

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[7] Such determinations are usually a matter of state law. See *Zimmerman* v. *Crothall*, 62 A.3d 676, 699-700 (Del.Ch. 2013) (defining standards for when a shareholder is a controlling shareholder under Delaware law). The state law standards for who is a controlling shareholder often involve case by case determinations. Under Delaware law, a shareholder is "controlling" if the shareholder "either owns more than 50% of the voting power of the company, or exercises 'actual control' over the board of directors during the course of a particular transaction." *Id.* at 699-700. Both of these tests for whether a controlling shareholder exists can become the subject of extensive litigation. See, *e.g.*, *Kelly* v. *Blum*, No. 4516-VCP, 2010 WL 629850, at *12 (Del. Ch. Ct. 2010) (defining powers

resolve difficult questions about the "legitimacy" of controlling shareholders' efforts to imbue the corporation with a religious identity.[8]

State courts, too, could become clogged with business disputes between shareholders who disagree over what religious identity, if any, their corporation

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that shareholder must possess to be a controlling shareholder, and citing *Paramount Comm'n Inc.* v. *QVC Network Inc.*, 637 A.2d 34, 43 (Del. 1994)); see also *Gould* v. *Reufenacht*, 471 U.S. 701, 706 (1985) (recognizing the complexities of determining what constitutes corporate "control" in closely-held businesses).

[8] Furthermore, questions regarding the "legitimacy" of the corporation's religious identity might not necessarily reduce to an inquiry into the beliefs of the controlling shareholders. For example, suppose that the controlling shareholders are concededly non-religious and yet, for business reasons, installed a set of directors who happen to be extremely religious. If, after receiving permission from the controlling shareholders, the directors were to pass a corporate resolution providing that the corporation adopts the directors' religious identity, would that resolution be "legitimate"? Or, suppose that, out of respect for a minority shareholder's strong religious beliefs, the corporation's non-religious controlling shareholders agree to amend the corporate charter in order to make clear that the corporation adopts the religious identity of the minority shareholder. Would that transaction qualify as "legitimate"? Or, suppose that a corporation's founding shareholders placed into the corporate charter a provision under which the corporate entity adopts their religious identity. If the founding shareholders were subsequently to bequeath their shares to their concededly non-religious grandchildren, would it be "legitimate" for the corporation to rely on its charter in seeking a RFRA-based regulatory exemption?

should adopt. The dispute might be between shareholders who agree that the corporation should adopt a religious identity but disagree over which one. Or, the dispute might be between majority shareholders who, for purely non-economic reasons, are opposed to having the corporation adopt a religious identity that would exempt it from certain regulations and minority shareholders who are focused on reducing the corporation's regulatory-compliance costs. Conversely, over the objection of minority shareholders who are solely interested in maximizing profit, the majority shareholders might seek to have the corporation adopt a religious identity even they anticipate that doing so will cause the corporation to lose customers.[9]

This Court should not take even a small step down this path. Rather than embracing a rule that says that shareholders claiming control of a corporation can impose their personal religious beliefs on minority (or even majority) shareholders and employees, the Court should reject the values pass-through theory.

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[9] Many states hold that controlling shareholders owe an absolute duty of loyalty to minority shareholders. See, *e.g.*, *Cede & Co.* v. *Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993).

B. Permitting Controlling Shareholders to Impose Their Religious Beliefs on Corporations Would Open the Courts to Many Issues Not Related to Contraception.

These cases raise not only questions of contraceptive and related women's health care. Allowing, or even compelling, corporations to adopt the religious beliefs of their shareholders could result in challenges to scores of other medical products or procedures that shareholders might deem objectionable. See Thomas E. Rutledge, *A Corporation Has No Soul—the Business Entity Law Response to the PPACA Contraceptive Mandate*, 5 Wm. & Mary Bus. L. Rev., at n. 74 (forthcoming 2014) (enumerating plausible religious objections to corporate funding of psychiatric care, treatment of illnesses related to the use of alcohol or tobacco, blood transfusions, delivery of babies born out of wedlock, and vaccination against the HPV virus). "The scope of the [contraceptive] Mandate is only a small subset of the medical procedures to which a Free Exercise objection could be raised." *Id.*

This case, moreover, raises not only questions under PPACA but also under the Civil Rights Act of 1964. Corporations have not raised the religious objections of shareholders as a basis for non-compliance with the public accommodations provisions of the Civil Rights Act. But, under a values pass-through theory, an incorporated business that withholds service from a person on the basis of race, gender, or religion, might

try to invoke the religious convictions of its shareholders as a defense.[10]

Similarly, there may be shareholders who have sincere religious convictions that women's place is in the home, or that men should not be engaged in work such as nursing or child care. Could the corporation, which the majority shareholders control, be allowed to invoke the religious beliefs of the majority shareholders as a defense to an employment discrimination claim brought under Title VII?[11]

Recognizing or allowing any kind of religious values pass-through from shareholders to corporations

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[10] In resisting enactment of the Civil Rights Act, clergymen and senators invoked the "will of God," the "Christian way," and "God's color line" based on biblical texts. See Michael Kent Curtis, *A Unique Religious Exemption from Antidiscrimination Laws in the Case of Gays? Putting the Call for Exemptions for Those Who Discriminate Against Married or Marrying Gays in Context*, 47 Wake Forest L. Rev. 173, 174-77 (2012) (surveying the climate surrounding the enactment of the Civil Rights Act); see also, Fred R. Harris, *The American Negro Today*, 10 Wm. & Mary L. Rev. 550, 555-56 (1969) (recounting biblical justifications for slavery and Jim Crow laws).

[11] At least one Title VII case might come out differently were the plaintiffs' arguments in these cases to prevail. See *EEOC* v. *Townley Eng'g & Mfg. Co.*, 859 F.2d 610 (9th Cir. 1988) (holding that, notwithstanding the deeply-held beliefs of the shareholders, a manufacturing company could not require a non-religious employee to attend a mandatory "devotional service" each week). One can imagine the range of Title VII claims that would erupt if for-profit businesses were permitted to impose religious job requirements based on the religious beliefs of the controlling shareholders.

would create a slippery slope that is easily avoidable. Thus, this Court should hold that the religious identity of a for-profit corporation's controlling shareholders, whether expressed through direct shareholder action or a board resolution, cannot excuse the corporation from strict compliance with generally applicable laws and regulations.

C. Permitting Corporations To Use Putative Religious Beliefs To Avoid Legal Obligations Gives Those Corporations Competitive Advantages and Incentivizes Subterfuge.

Corporations have a duty, enforceable within corporate law itself, to obey the law. See Model Bus. Corp. Act § 3.02(15) (authorizing a corporation to "do any other act, *not inconsistent with law*, that furthers the business and affairs of the corporation" (emphasis added)). Indeed, in every American jurisdiction, corporations are chartered only for lawful purposes and illegal acts have long been considered *ultra vires*. See generally Kent Greenfield, *Ultra Vires Lives! A Stakeholder Analysis of Corporate Illegality (With Notes on How Corporate Law Could Reinforce International Law Norms)*, 87 Va. L. Rev. 1279 (2001).

Oklahoma and Pennsylvania both acknowledge the obligation for corporations to act lawfully. See 18 Okla. Stat. § 1005 ("A corporation may be incorporated * * * to conduct or promote any lawful business or purposes."); 15 Pa. Cons. Stat., § 1301 ("Corporations may be incorporated under this subpart for any lawful purpose or purposes.").

A related principle of corporate law holds that a corporation may not knowingly violate the law, even if

the board authorizes it. See *Miller* v. *Am. Tel. & Tel. Co.*, 507 F.2d 759 (3rd Cir. 1974) (holding that the board was not insulated by the business judgment rule when it authorized non-collection of unpaid telephone bills in violation of the Communications Act of 1934).

The reasons for this insistence on legal obedience, beyond the obvious importance of legality to society at large, include the urgency of maintaining a fair and level playing field for all businesses. A competitive marketplace depends on the principle that competition among firms should be on grounds of efficiency, and should not depend on which companies are better at skirting legal obligations.

As a general matter, a corporation will enjoy a competitive advantage in the marketplace if it is exempted from otherwise generally applicable laws and regulations (namely, because the exemption will reduce the corporation's costs of doing business). In this case, Hobby Lobby and Conestoga are asking to be relieved from providing a standard of health care coverage that their competitors are required to provide. Regardless of the companies' purpose, the effect of their legal arguments would be to skew the level playing field of the market, giving an advantage to companies claiming regulatory exemptions. Companies that do not assert religious beliefs will find themselves competing at a disadvantage, on grounds that have nothing to do with efficiency.

If this Court were to accept Hobby Lobby's and Conestoga's arguments, what would prevent a corporation from invoking religion essentially at will in order to obtain exemptions from generally applicable laws and regulations that the corporation finds too

costly? Are federal courts prepared to adjudicate complex (and potentially intrusive) questions of whether a given corporation is invoking religion merely as a subterfuge to gain an economic advantage over competitors, rather than in "good faith" (however a court might define that term)?[12] And, if federal courts are not prepared to entangle themselves in such questions, will boards of directors be duty-bound to shareholders to adopt some form of religious identity, so as to exempt the corporation from the greatest number of generally applicable laws and regulations?

These questions do not represent a mere parade of horribles. Rather, it is very easy to imagine how companies would react if this Court were to rule in favor of Hobby Lobby and Conestoga. Companies suffering a competitive disadvantage will simply claim a "Road to Damascus" conversion. A company will adopt a board resolution asserting a religious belief inconsistent with whatever regulation they find obnoxious, whether it be a state's insistence that companies not discriminate on the basis of sexual orientation, Title VII's obligation that women be paid the same as men, or PPACA's requirement of

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[12] Even assuming that federal courts were permitted to engage in such an inquiry, they would be stepping outside of their traditional area of expertise. See *Thomas* v. *Review Bd.*, 450 U.S. 707, 716 (1981) ("[I]t is not within the judicial function and judicial competence to inquire whether the petitioner or his fellow worker more correctly perceived the commands of their common faith. Courts are not arbiters of scriptural interpretation.").

providing health insurance that includes contraceptive coverage.

Unless federal courts were authorized and prepared to make inquiries into the "legitimacy" or good faith nature of the corporation's putative religious beliefs, then the only checks on all of this would be labor unrest or consumer disgust. And, even if federal courts *were* authorized and prepared to enmesh themselves in the chore of determining whether a corporation's assertion of religious beliefs is in good faith or a mere subterfuge, this chore would not be easy. The evidence typically will be no more, and no less, than what is present in this case: the views of shareholders that the regulation burdens their personal beliefs and a board resolution adopting those beliefs as the corporation's own.

CONCLUSION

Hobby Lobby's and Conestoga's RFRA claims rest on arguments that are contrary to well-established principles of corporate separateness that are recognized by corporate law, criminal law, and agency law. The judgment of the Tenth Circuit should be reversed and the judgment of the Third Circuit should be affirmed.

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